

AUDIT SUMMARY

Our audit of the Virginia Small Business Financing Authority for the year ended June 30, 1998, found:

- proper recording and reporting of transactions, in all material respects, in the Authority's financial accounting records;
- a certain matter that we consider a reportable condition; and
- no instances of noncompliance that are required to be reported.

AGENCY HIGHLIGHTS

The Virginia Small Business Financing Authority provides financial assistance to small businesses in the Commonwealth by providing loans, guarantees, insurance, and other assistance, thereby encouraging the investment of private capital in small business. The Authority issues industrial development bonds and guarantees small business loans for banks.

The Authority's operating revenue and expenses during fiscal year 1998 were \$179,809 and \$194,852, respectively. Significant revenue collections included industrial development bond fees, interest, and loan guarantee fees. The Authority's expenses consisted primarily of payroll and fringe benefits, and travel expenses. The Authority invests excess cash in the Local Government Investment Pool (LGIP). Investments totaled \$1,655,653 at June 30, 1998.

The Director of the Department of Business Assistance appoints the Authority's Executive Director. Further, the Department provides office space and pays certain administrative expenses, including the Executive Director's salary.

Loan Guarantees

The Authority guarantees loans made to small businesses by banks. As of June 30, 1998, the Authority had outstanding loan guarantees totaling \$1,047,302. The Authority is required to maintain a loan loss reserve amounting to 8 percent of the outstanding loan balance. At fiscal year-end, this loss reserve amounted to \$83,784. If a loan goes into default, the Authority covers the guarantee out of the loan loss reserve fund. Lending banks pursue collection of loans in default. The Authority receives a portion of the recovered funds as reimbursement on the loan guarantee paid to the bank. Historically, the loan default rate has been 4.7 percent and defaults since inception have amounted to \$427,150.

Child Care and Development

The Authority manages a portion of the Child Care and Development Block Grant by providing the Child Day Care Financing Program. The Authority's responsibilities include taking applications, approving and making direct loans, developing and implementing marketing programs, and providing oversight and supervision to the manager of the loan program. The block grant reimburses the Authority for the program's administrative expenses. At June 30, 1998, the outstanding loan balance was \$1,180,622. Loan defaults since the program's inception total \$118,111.

Economic Development Revolving Loans

The Virginia Economic Development Revolving Loan Fund provides loans to small companies to bridge the gap between private debt financing and private equity. The Virginia Defense Conversion Revolving Loan Fund provides loans to defense-dependent companies seeking to diversify and expand into commercial markets. At June 30, 1998, the Economic Development Revolving Loan Fund had \$7,065,489 in loans outstanding and a cash balance of \$6,415,722. The Defense Conversion Revolving Loan Fund had \$1,000,036 in loans outstanding and a cash balance of \$1,471,138. Defaulted loans for these funds since inception total \$1,886,593. The Authority works with a law firm, assigned by the Attorney General's office, to pursue collection of any defaulted loans.

Bond Issuances

The Authority assists credit-worthy businesses in gaining access to public and private long-term financing at favorable interest rates and terms. As a conduit issuer of both tax exempt and taxable bonds, the Authority tracks which businesses need financing and determines the economic benefit on a statewide level. The Authority does not actually issue any funds or collect loan principal payments. The repayment of individual development bonds is solely the responsibility of the borrower. Neither the Authority nor the Commonwealth guarantee repayment. The Authority charges an administration fee of 1/8 of 1 percent per annum of the outstanding principal amount of the bonds. The fee is payable annually on each anniversary date of the closing of the bond issue.

Finding and Recommendation:

Current administrative fee billing procedures are manual and involve note cards in a file box that accountants update for billings and payments. We found several instances of untimely billings and recording of receipts. These delays occurred because personnel did not follow the Authority's billing and follow-up procedures. We recommend that the Authority improve their billing and follow-up procedures to include appropriate supervisory review of personnel performing work to ensure its timeliness. The Authority should consider maintaining bondholder information on a computerized database. This could help improve the entire process.

February 12, 1999

The Honorable James Gilmore, III
Governor of Virginia
State Capitol
Richmond Virginia

The Honorable Richard J. Holland
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

We have audited the financial records and operations of the **Virginia Small Business Financing Authority** for the year ended June 30, 1998. We conducted our audit in accordance with generally accepted government auditing standards.

Audit Objective, Scope, and Methodology

Our audit's primary objectives were to review the Authority's accuracy of recording financial transactions in its financial accounting records, adequacy of the internal control structure, and compliance with applicable laws and regulations.

Our audit procedures included inquiries of appropriate personnel, inspection of documents and records, and observation of the Authority's operations. We also tested transactions and performed such other auditing procedures as we considered necessary to achieve our objectives. We reviewed the overall internal accounting controls, including controls for administering compliance with applicable laws and regulations. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances:

Revenues	Expenditures
Federal Compliance	

We obtained an understanding of the relevant policies and procedures for these internal accounting controls. We considered materiality and control risk in determining the nature and extent of our audit procedures. We performed audit tests to determine whether the Authority's policies and procedures were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations.

The Authority's management has responsibility for establishing and maintaining an internal control structure and complying with applicable laws and regulations. The objectives of an internal control structure are to provide reasonable, but not absolute, assurance that assets are safeguarded and that transactions are processed in accordance with management's authorization, properly recorded, and comply with applicable laws and regulations.

Our audit was more limited than would be necessary to provide an opinion on the internal control structure or on overall compliance with laws and regulations. Because of inherent limitations in any internal control structure, errors, irregularities, or noncompliance may nevertheless occur and not be detected. Also, projecting the evaluation of the internal control structure to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Audit Conclusions

We found that the Authority properly stated, in all material respects, its financial information in the financial and accounting records. The Authority records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles. The financial information presented in this report came directly from the Authority's accounting records.

We noted a matter involving the internal control structure and its operation that we considered to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the Authority's ability to record, process, summarize, or report financial data consistent with the assertions of management in the financial records. This reportable condition is discussed in the section entitled "Bond Issuances." We do not believe the reportable condition is a material weakness.

The results of our tests of compliance disclosed no instances of noncompliance that are required to be reported herein under generally accepted government auditing standards.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on February 24, 1999.

AUDITOR OF PUBLIC ACCOUNTS

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jld:36